INDEX

	PAGE
Opinion	1
Jurisdiction	1
Constitutional and Statutory Provisions Involved	2
Questions Presented for Review	3
Statement of the Case	3
Summary of Argument	8
Argument:	
Question I	9
Question II	16

TABLE OF CITATIONS

	Page
S. C. Act No. 349, Acts of 1969, Section 25	3
Tilton v. Richardson, 403 U. S. 672	6, 9
Hunt v. McNair, 1987 S. E. (2d) 645	1
Lemon v. Kurtzman, 403 U. S. 602	9
Earley v. DiCenso, 403 U. S. 602	9
Robinson v. DiCenso, 403 U. S. 602	9
Section 103, Internal Revenue Code of 1954	14
U. S. Constitution, Amendment 1	3
Walz v. Tax Commission of the City of New York, 397 U. S. 664	14

IN THE

Supreme Court of the United States

No. 71-1523

RICHARD W. HUNT, APPELLANT,

versus

ROBERT E. McNAIR, GOVERNOR OF THE STATE OF SOUTH CAROLINA, ET AL., APPELLEES

ON APPEAL FROM THE SUPREME COURT OF SOUTH CAROLINA

BRIEF OF APPELLEES

OPINION

The statements made in the Appellant's Brief on this subject are sufficient.

JURISDICTION

The statements made in the Appellant's Brief on this subject are sufficient.

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

Omitted from the statutory provisions herein involved is the definition of "Project" as that term is used in the South Carolina Educational Facilities Authority Act.

The type of project which the South Carolina Educational Facilities Authority is permitted to undertake is defined as follows:

(b) "Project", shall mean a structure or structures available for use as a dormitory or other housing facility, including housing facilities for student nurses, a dining hall, student union, administration building, academic building, library, laboratory, research facility, classroom, athletic facility, health care facility, and maintenance, storage or utility facility and other structures or facilities related thereto or required or useful for the instruction of students or the conducting of research or the operation of an institution for higher education, including parking and other facilities or structures essential or convenient for the orderly conduct of such institution for higher education, and shall also include landscaping, site preparation, furniture, equipment and machinery and other similar items necessary or convenient for the operation of a particular facility or structure in the manner for which its use is intended but shall not include such items as books, fuel, supplies or other items the costs of which are customarily deemed to result in a current operating charge, and shall not include any facility used or to be used for sectarian instruction or as a place of religious worship nor any facility which is used or to be used primarily in connection with any part of the program of a school or department of divinity for any religious denomination.

QUESTIONS PRESENTED FOR REVIEW

1. Does the financial arrangement contemplated by the South Carolina Educational Facilities Authority Act create impermissible State involvement in the affairs of the Baptist College at Charleston in violation of the establishment clause of Amendment I to the Constitution of the United States?

2. Does that provision of the State Board's regulations which permits the removal of the restriction against religious use of financed facilities in the event of a judicial sale under mortgage foreclosure advance religion in contravention of the First Amendment?

STATEMENT OF THE CASE

The South Carolina Educational Facilities Authority Act (Section 25 of Act No. 349 of the Acts of the General Assembly of South Carolina for the year 1969, 1969 Acts, Page 603), hereinafter called "the Act", was enacted for the purpose of rendering a measure of assistance to the private institutions of higher education in South Carolina and to provide an alternative method of enabling such institutions to undertake the projects defined in the Act.

In essence it provides for a sale of South Carolina special revenue bonds whose proceeds would pay for Projects undertaken by an institution for higher learning and which would be repaid by lease payments or other charges made by the institution. Since interest on the bonds would not be subject to State or Federal Income Tax by the recipients thereof, the interest cost to the institution would be substantially less than if the institution borrowed in conventional fashion. Roughly speaking, the savings could be as much as 2% per annum. On a $1 Million undertaking with a 20-year average maturity, this would amount to $400,000.00.

There are some nineteen 4-year private colleges in South Carolina. Of these, thirteen are church related and include institutions sponsored by the Baptist Church, Presbyterian Churches and the Episcopal Church. In addition, there are some eight private Junior Colleges, of which six are church related and two are non-church related. All of these institutions fall into the category of institutions for higher learning, as that term is defined in the Act. Among the nineteen 4-year private colleges is the Baptist College at Charleston. The affairs of the College are managed by a Board of Trustees which has as its policy no restriction upon the enrollment or faculty based upon the religion of the faculty members or students. The College was founded by the Baptist Convention of South Carolina and the purpose of the College as stated in its Charter is to operate a Baptist liberal arts college for educational purposes. The College is attended by Roman Catholics, Protestants, Jews, and members of other religious denominations. Its faculty includes representatives of several different denominations.

The financial transaction which is contemplated by the Act is so similar in nature to the so-called "Industrial Development Bond" that a comparison of the two will clarify the nature of the State's role in providing assistance through the procedure permitted by the Act.

In the case of the Industrial Development Bond Act the issuing agency in South Carolina is the county. In other states public authorities or municipalities are sometimes the issuing agencies, but the function of all is substantially the same. In South Carolina the county and the industry enter into what is generally called a lease agreement. Under the terms and provisions of this agreement the county acquires the land and agrees to finance the construction of the desired industrial facility. Simultaneously it leases the same to the industry at a rental sufficient to pay the principal and interest of the bonds, and to discharge

other obligations incident to ownership, such as maintenance and insurance. As a general rule the agreement provides that the industry will purchase the project for $1.00 upon payment of the bonds. This type of lease requires the industry to make the rental payments free of claim or offset. This type of agreement is essentially an installment purchase. The county then (simultaneously) enters into an indenture which makes provision for the issuance of the county's industrial development bonds. The county not only mortgages the project, but also assigns to the trustee under the indenture all of the county's rights under the lease agreement. The bonds are then issued; their proceeds deposited with the trustee bank, which thereafter causes them to be applied to the construction of the project. Once the bonds are issued, the county steps aside, and from that time on, the bondholder looks to the trustee to enforce the county's rights under the lease and to require the industry to pay the rentals required to pay the principal and interest of the bonds. The county's real function in the transaction is to issue bonds whose interest has a tax free status.

The routine followed in the case of industrial development bonds is parallelled under the Act. Here the Authority would acquire the project site and take title to the same; simultaneously enter into a lease agreement with the College, which would obligate the College to pay, by way of rent or other charge, an amount sufficient to provide for the payment of the principal and interest of the bonds to be issued by the Authority. The Authority would simultaneously enter into a trust indenture with a trustee bank, pursuant to which the bonds would be issued. The Authority would mortgage the project for the security of the bonds. In addition, the Authority's rights under the lease agreement would be assigned to the trustee bank.

At this point in time the Authority would, from a practical standpoint, step aside and thence forward the bondholders would look to the trustee for their rights and remedies. In the case of industrial development bonds issued by South Carolina counties, the county is a conduit pure and simple. In the case of bonds issued under the Act, the Authority is likewise a conduit pure and simple, with but a single exception.

The State Act here, like the Federal act involved in *Tilton v. Richardson*, 403 U. S. 672 (1971), specifically requires that no project undertaken by the Authority be used for sectarian instruction, or as a place of religious worship, or in connection with any part of a program of a school or department of divinity for any religious denomination. In order to implement this provision of the Act, the Authority adopted regulations which, among other things, require that the lease agreement must contain:

1. A covenant prescribing that neither the leased land, nor the facility located thereon, shall be used for sectarian instruction or as a place of religious worship, or in connection with any part of the program of a school or department of divinity of any religious denomination.

2. A provision permitting the Authority or any agent of the Authority to conduct such inspections as may be necessary to determine whether the covenant set forth in 1 is being complied with.

3. A provision agreeing that the covenant set forth in 1 above could be enforced by the Authority, the Attorney General of South Carolina, or any taxpayer.

The final requirement for the lease agreement goes to the use of the project following the repayment of the bonds. Unlike the Federal act involved in *Tilton*, which provided for a gift of Federal money for use in the construction of a building or like facility with a definite life, measurable in years, it was recognized here that a project under

the Act might provide for the acquisition of land with part of the proceeds of bonds. Accordingly, to comply with the spirit of the plurality opinion in *Tilton* it became necessary to require that the project continue to be devoted to non-sectarian purposes.

After the bonds have been issued, only two results could obtain. The bonds would be paid and the project conveyed to the institution, or, the mortgage would be foreclosed and the property would be put up at public sale.

Most of the private institutions of higher learning in South Carolina are far from wealthy and the security afforded by a forecloseable mortgage is essential to the proper marketing of bonds. Accordingly, the final provision required in the lease agreement is that if the bonds are paid off, the reconveyance shall be subject to the condition that the project not be used for sectarian instruction or as a place of worship or in connection with any part of a program of a school or department of divinity of any religious denomination. Such a condition enforces the continued use of the project for non-sectarian purposes. On the other hand, if the bonds were not paid and the project foreclosed, the particular institution benefited by the State action would no longer be in the picture, and the purchaser at the judicial sale would be entitled to a good and marketable title, free of liens, claims, conditions or encumbrances. Without such a title the basic security afforded by the forecloseable mortgage would be diminished, creating serious difficulty in marketing the bonds.

SUMMARY OF ARGUMENT

Inasmuch as simultaneously with the consummation of the loan contemplated by the Act, all rights of the Authority are assigned to a trustee bank to enforce the rights of the bondholders with respect to the repayment, the Authority is no longer involved with the College except to the limited extent of inspections as to use. The resulting relationship here between the Authority and the College, therefore, is basically the same as the resulting relationship in *Tilton*.

When considered in the light of the applicable guidelines, any entanglement in this case would be no more offensive than the entanglement in *Tilton*, and the South Carolina Supreme Court on remand has so determined. This decision of the South Carolina Supreme Court which was expressly sought by the United States Supreme Court should be permitted to stand unless the findings of the South Carolina Supreme Court are clearly erroneous; a situation which does not exist.

The entanglement here is substantially different from the entanglement in *Tilton* and *DiCenso* due to the absence here of the use of any tax revenues; consequently the assistance provided the Baptist College is the result of a tax exemption which cannot be denied on First Amendment grounds. The continuing inspection as to use does not create any impermissible entanglement.

The provisions of the regulations permitting the removal of the restriction against religious use of financed facilities in the event of a judicial sale under mortgage foreclosure constitutes no benefit to the Baptist College and hence, does not offend the First Amendment.

Question I

Does the financial arrangement contemplated by the South Carolina Educational Facilities Authority Act create impermissible State involvement in the affairs of the Baptist College at Charleston in violation of the establishment clause of Amendment I to the Constitution of the United States?

In its *Per Curiam* decision rendered March 2, 1972, following the remand of this case by the Supreme Court of the United States on June 28, 1971 (403 U. S. 945, 91 S. Ct. 2276, 29 L. Ed. (2d) 854) the Supreme Court of South Carolina reconsidered its prior holding in the light of the decisions of the Supreme Court of the United States in the cases of: *Lemon, et al. v. Kurtzman, et al.*, 403 U. S. 602, 91 S. Ct. 2105, 29 L. Ed. (2d) 745; *Tilton, et al. v. Richardson, et al.*, 403 U. S. 672, 91 S. Ct. 2091, 29 L. Ed. (2d) 790; *Earley, et al. v. DiCenso, et al.*, 403 U. S. 602, 91 S. Ct. 2105, 29 L. Ed. (2d) 745, and *Robinson, et al. v. DiCenso, et al.*, 403 U. S. 602, 91 S. Ct. 2105, 29 L. Ed. (2d) 745. It held that the Act was a valid exercise of the legislative power of the General Assembly of South Carolina and stated: "It has a secular legislative purpose. It neither advances nor inhibits religion. There is no fostering of an excessive government entanglement with religion."

The appeal here concerns itself merely with the last statement, *viz.*, it challenges the holding of the South Carolina Supreme Court that the Act would not foster an excessive government entanglement with religion. In its holding the South Carolina Supreme Court noted the similarity of the situation which exists under the Act and the situation which existed in the *Tilton* case. In *Tilton* there was a government grant made directly to the institution upon a showing that the facility to be constructed with the proceeds of the grant would be used for secular pur-

poses. The Federal act enforced that provision by prescribing that any violation would subject the recipient of the grant to the obligation to repay an amount equal to the proportion of the facility's then value that the Federal grant bore to the original cost. The remedy which was made available to the Government for a 20-year period, was in effect rewritten by the Court's removal of the 20-year limitation.

Under the South Carolina Act no grant is made. Therefore, other means had to be prescribed to insure compliance with the covenant that the project would not be used for sectarian or religious purposes. This is accomplished by the covenant which is enforceable by the Authority, by the Attorney General or by any taxpayer. But, apart from the remedy, the two situations are basically similar for the reason that a single transaction is involved.

The Appellant stresses the State's continuous obligation to supervise fees or other charges imposed by the institution in order to determine that they are sufficient to meet bond payments. In so doing the Appellant avoids the substance of the transaction. The Act prescribes, and the lease agreement will provide, an obligation on the institution to pay, without offset or other claim, rental or charges sufficient to pay the principal and interest of the bonds. It is true that this agreement is made between the institution and the Authority. However, simultaneously with the consummation of the transaction the rights of the Authority are assigned to a trustee bank under the indenture, and thenceforth the trustee, in discharge of its duties under the indenture, would exercise those rights, so that if default arose the action which would follow would be instituted by the trustee for the benefit of the bondholders and while presumably the Authority might be a party to such an action, the result sought by the action would either be for the enforcement of the covenants made

by the institution in the lease agreement or for the foreclosure of the mortgage. From a practical standpoint, there is no entanglement on the part of the State, but even if there were a failure on the part of the trustee to act, and voluntary action on the part of the State, it would not involve entanglement by the State and the institution. It would simply be a creditor's action to enforce financial obligations incurred by the institution.

Private colleges, be they church supported or otherwise, like private individuals and private corporations, are required to make financial arrangements in order to exist. Borrowing money is unfortunately an every day part of their business life.

Appellees assume that because of the far-reaching effect of this decision the Court will judge the transaction here involved in the light of its substance and that if a majority adhere to the plurality opinion in *Tilton*, it will treat the transaction as a simple financial arrangement made by the State for the borrowing institution with the lending bondholders.

The Court's attention is directed to the fact that while no bonds have been issued pursuant to the South Carolina Act, since this is the declaratory action to determine the validity of the Act, in the light of the First Amendment question, many other States have similar acts which have been in effect for a great many years. Under these acts bonds have been issued and are outstanding, the proceeds of which were used directly or indirectly by church supported institutions of higher learning for secular facilities. The effect of the decision here will transcend its importance to the parties to this case and the institutions for higher learning in South Carolina. An adverse decision could have serious impact upon church supported institutions for higher learning throughout the United States. This has not been written to suggest that the result

here should simply be an expedient one. It is written to emphasize the argument that the substance of the transaction should be considered, rather than its form.

A further factor should be considered by this Court in reaching its decision. On the first appeal to this Court its majority neither set the case for argument nor ordered it reversed, but on the contrary, returned the case to the Supreme Court of South Carolina, in order that that Court might reconsider its previous holding in the light of *Lemon, Tilton,* and the two *DiCenso* cases. The Supreme Court of South Carolina has so reconsidered this case and has found that the substance of the transaction between the State, the institution for higher learning, and those who would lend money for the benefit of the institution for higher learning is as set forth in the argument here. It has further found, on that basis, that no excessive entanglement with religion will result.

Presumably, this Court would not have returned this case to the Supreme Court of South Carolina for reconsideration if it did not intend to attach weight to its findings. Accordingly, we respectfully suggest that unless such findings are clearly erroneous, the factual results as found by the South Carolina Supreme Court should stand. We do not believe that a clearly erroneous situation exists.

The majority opinion in *DiCenso* sets forth the guidelines to be considered in determining whether an excessive entanglement results. When considered in the light of the guidelines, there is less entanglement here than there was in *Tilton.*

With regard to the first guideline, the **character and purpose of the institution benefitted,** the institutions involved in *Tilton* were governed by Catholic religious organizations and the faculties and student bodies were predominantly Catholic. No "religious organization" governs

the Baptist College, and its student body is only about 60% Baptist, which is the ratio of Baptists in South Carolina. Finally, there is no requirement here, as there was at the institutions benefited in *Tilton,* that students must take theology courses.

With regard to the second guideline, **the nature of the assistance provided,** in both cases the assistance provided is of a non-ideological character in the form of neutral facilities. Moreover, of vital significance is the fact that the assistance here does not originate from tax revenues and, therefore, no taxpayer is required to contribute to the financing of facilities at the Baptist College.

Finally, with regard to **the resulting relationship between the government and the religious organization,** the form of the relationship here differs from the form of the relationship in *Tilton,* but, in substance, the resulting relationship is no more entangling. As pointed out hereinabove, once the assistance has been provided through the issuance of the bonds and the proceeds have been turned over to the trustee, the relationship between the State and the Baptist College is, in fact, ended, except for inspection as to use.

On remand, the South Carolina Supreme Court carefully considered the facts of this case in the light of the guidelines and concluded: "When one considers the character and purpose of the College and the nature of the assistance provided, and the resulting relationship between the government and the College, it necessarily follows that there is less potential for experiencing the substantive evils which the religious clauses were intended to protect than in *Tilton.*"

In the foregoing discussion, we have considered the question of entanglement as one of degree, comparing the extent of entanglement in this case with the extent of entanglement in *Tilton.* However, there is a distinction

in substance between the relationship in *Tilton* and *Di-Censo* and the relationship which will result here between the Educational Facilities Authority and the Baptist College. The substantial difference is the absence in this case of the use of any tax revenues, with the result that (1) there is no use of taxes collected from the citizens of all faiths and of no faith, and (2) there is no danger of competition among religious groups for State appropriations.

The assistance here is by way of a tax exemption provided by Section 103 of the Internal Revenue Code of 1954 for interest on State obligations. In 1969 Congress limited the availability of this exemption for the benefit of private corporations, but expressly excluded from limitations otherwise imposed on industrial development bonds obligations issued for the benefit of certain non-profit institutions. This federal tax exemption has, by virtue of the Act of the South Carolina General Assembly under consideration, been made available to institutions of higher learning in the State of South Carolina as defined in the Act.

The substance of this assistance is the same as would be afforded to the Baptist College if Congress, instead of permitting indirect tax free borrowing, exempted from Federal income taxes interest paid by non-profit educational institutions on loans incurred to finance the acquisition, construction, enlargement and renovation of necessary land and buildings. Considered in that light, such an exemption cannot be denied a sectarian institution on First Amendment grounds, *Walz v. Tax Commission of the City of New York*, 397 U. S. 664.

Against that background, even the continuing relationship between the State and the Baptist College is not impermissible entanglement. As far as inspection as to use is concerned, State and local governments exercise a continuing surveillance daily to insure compliance with literally hundreds of laws relating to the use of religious

facilities in every state of the nation, including zoning laws, health and fire regulations, etc. Here the continuing relationship is likewise merely to insure that the use of the facilities complies with all of the applicable statutes and regulations. The enforcement of such limitations as to the use of religious facilities does not, *per se,* result in any impermissible entanglement; and such enforcement has been classified by the Court decisions as impermissible entanglement only where the violation of such restrictions as to use would result in the use of tax moneys, extracted from all taxpayers, for the benefit of a religion.

The other aspect of the continuing relationship relates to the repayment of the bonds. As previously discussed, all of the State's functions in this regard are transferred to a trustee. That the State plays no role insofar as the repayment of the bonds is concerned can be made more obvious by eliminating the State altogether from the repayment procedure. Assume that the State, simultaneously with the issuance of the bonds and the leasing of the property to the Baptist College, conveys the leased property by deed to the trustee, subject to the lease, as security for the bondholders. If such a transfer were made the mere formal involvement of the State would no longer exist, and the State obviously could have no role with respect to repayment of the bonds. However, the relationship of the parties in interest, *viz.* the College, the trustee and the bondholders, their respective rights with respect to the property involved, and the bondholders' rights with respect to repayment would not be altered one iota by such a conveyance. Consequently, mere retention of title by the State is of no effect whatsoever and gives rise to no continuing relationship between the Baptist College and the State.

If there should be any lingering doubts on this point, we invite the Court to follow the course followed in *Tilton*

and to strike the offending authorizations of the Act and to sustain the balance of the Act.

Question II

Does that provision of the State Board's regulations which permits the removal of the restriction against religious use of financed facilities in the event of a judicial sale under mortgage foreclosure advance religion in contravention of the First Amendment?

The challenge here goes to the last provision of the State Authority's regulations relating to the lease agreement, which in substance provides that if the mortgage given by the Authority to the indenture trustee is foreclosed, the purchaser at the judicial sale will receive a clear title to the premises, free of the covenant applicable to the institution or any voluntary grantee of the institution, relating to the future use of the foreclosed properties. This is thought to be an essential provision in the structuring of the financial arrangement which is essentially one between the institution and its lenders (the bondholders).

In South Carolina, at least, private institutions of higher learning, including church supported colleges, are almost inevitably impecunious borrowers. Hence, the security afforded by the mortgage on the project undertaken by the institution is very real security and an essential inducement to the loan. If foreclosure takes place, the institution will no longer have an interest in the subject property. Any benefit derived from the sale of the property will pass to a third party. The result would be precisely the same result that would obtain had the institution borrowed directly from the lender rather than through the arrangement made with the State Authority. In most instances the institution will have owned the property that is to be mortgaged prior to the issuance of the bonds. Such

are the facts in the case here, where part of the security for the arrangement sought by the Baptist College consists of property already owned by the institution. It is that specific property which would be conveyed to the Authority and mortgaged by the Authority for the security of the bonds. Certainly, under the facts of this case, no advantage with respect to the use of the property has been obtained by the Baptist College. The quotation from *Tilton* in the Appellant's Brief that the unrestricted use of valuable property is in effect a donation of some value to a religious body, overlooks the fact that subsequent use of the property following foreclosure would not be by the institution participating in the transaction, but by third parties.

CONCLUSION

It is respectfully urged that the judgment of the Supreme Court of South Carolina should be upheld.

Respectfully submitted,

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